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IN SUPPORT OF

HB 5281

**AN ACT CONCERNING AMENDMENTS TO THE
CONNECTICUT UNIFORM PRINCIPAL AND INCOME ACT**

**Judiciary Committee
March 12, 2010**

Thank you for the opportunity to appear before the Committee to comment on House Bill 5281. My name is John Ivimey. I am a principal of Reid and Riege, PC in Hartford, Vice Chair of the Connecticut Bar Association Estates and Probate Section and a fellow of the American College Trust and Estate Counsel.

The Estates and Probate Section proposed this bill regarding amendments to the Connecticut Uniform Principal and Income Act. The Principal and Income Act governs how a trust allocates receipts and expenses as between income beneficiaries and remainder beneficiaries. While in many cases, creators of trusts are free to determine in the document how these items should be allocated, the Principal and Income Act is a "default" rule that governs in the absence of specific direction. Connecticut adopted this version of the Uniform Principal and Income Act in 1999.

The changes proposed in House Bill 5281 are quite technical in nature but can be quite important in certain circumstances. The first change has to do with how receipts from a deferred compensation plan, such as an IRA are treated when paid to a trust that is intended to qualify for the federal estate tax marital deduction. It is not uncommon for the owner of an IRA account to provide that the proceeds upon his or her death are paid to a trust for the surviving spouse. This is particularly true in the case of second marriages. Oftentimes, the plan is that the payment to this trust will qualify for the federal and state marital deduction so that no estate tax is paid in the first estate but is postponed until the surviving spouse dies. The most typical way of providing for this outcome (called the 'marital deduction') is through a "QTIP Marital Trust" where the surviving spouse must receive all of the trust income. In rulings that were issued a few years ago, the IRS provided that if

the trust is properly structured, then the marital deduction would be available. However, those IRS rulings required that special provisions be included in the trust document.

The IRS found that the default provisions in statutes such as the Connecticut Uniform Principal and Income Act were not adequate to comply with the tax requirements. Accordingly, the proposed amendment to the Connecticut statute provides that even where the trust agreement itself does not include the provisions required by IRS, a payment to a trust otherwise qualifying for the marital deduction will be eligible. The change in the statute provides that "internal income" of the IRA itself (meaning interest and dividends) may be withdrawn at all times by the surviving spouse.

The second change has to do with the allocation of income taxes for trusts that receive receipts from a "pass through entity" like a partnership, LLC or an S corporation. Under some interpretations of the existing statute, a problem can arise where a trust is required to distribute all of its income to a trust beneficiary and it receives a distribution from a pass through entity. In general, this cash distribution is treated as income and would pass through to the beneficiary. However, there can be instances where the taxable income attributable to the pass through entity that must be reported by the trust exceeds the cash distribution. In other words, the trustee would have an income tax obligation but not have cash available with which to pay the tax. This change would in effect allow the trustee to withhold a portion of the cash in order to pay the income tax liability.

These are modest but important changes to our Uniform Principal and Income Act. On behalf of the Estates and Probate Section, I urge the Committee to approve House Bill 5281.